

ST 03-0001-PLR 01/13/2003 MANUFACTURING MACHINERY & EQUIPMENT

Under the Retailers' Occupation Tax Act, the manufacturing machinery and equipment exemption is available for machinery and equipment used primarily (over 50% of the time) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease. See 86 Ill. Adm. Code 130.330. (This is a PLR.)

January 13, 2003

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see www.revenue.state.il.us/Laws/regs/part1200/), is in response to your letter of December 4, 2002. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

On behalf of our client, the Illinois-based company identified above ('Company'), we are writing to request a Private Letter Ruling regarding eligibility for the manufacturing machinery and equipment exemption and the rolling stock exemption authorized under Section 2-5 of the Retailers Occupation Tax Act (35 ILCS 120/2-5), Section 2 of the Service Occupation Tax Act (35 ILCS 115/2), Section 2 of the Service Use Tax Act (35 ILCS 110/2), and Section 3-5, 3-50, 3-60 and 3-61 of the Use Tax Act (35 ILCS 105/3-5, 3-50, 3-60 and 3-61). Together, these acts are referred to as the 'Sales Tax Acts.' Department Regulations relating to the exemptions include Section 130.330, Manufacturing Machinery and Equipment (86 Ill. Adm. Cd. 130.330) and Section 130.340, Rolling Stock (86 Ill. Adm. Cd. 130.340). The Company is requesting the ruling to confirm its understanding that a reorganization of its business operations will result in eligibility for the manufacturing machinery and equipment ('MM&E') exemption and the rolling stock exemption. This request is made in accordance with Section 1200.110 of Title 2 of the Illinois Administrative Code, and includes the information required pursuant to Section 1200.110, subsections (b)(1) through (b)(7).

The Company, a regular corporation that files an IL-1120, is currently in the business of road building and heavy construction. It is treated, therefore, as a construction contractor under the Sales Tax Acts. As a part of its business, it owns and operates facilities used to manufacture materials, such as asphalt and concrete, used in road building and heavy construction. In addition, the Company owns several vehicles used to transport raw materials, asphalt and concrete products, and construction equipment.

The Company uses most of the asphalt and concrete products it manufactures in its own road building and construction operations. It also sells a portion of those products (less than 50%) to other customers. In the same manner, the Company uses its trucks primarily to transport products and equipment used in its own construction operations. However, it also transports products for other, unrelated customers.

The Company intends to reorganize its operations effective January 1, 2003, to split its business functions into three separate entities--one for construction, one for manufacturing and one for transportation. Its business reason for reorganization relevant to this ruling request is to establish eligibility for exemptions available under the Sales Tax Acts.

First, the Company intends to create a single member limited liability company to which it will transfer all manufacturing assets. This LLC ('LLC #1') will be a manufacturing company, performing all the manufacturing functions currently performed within the Company. LLC #1 will sell 100% of its products to the Company or to other, unrelated parties. More than 50% of its product sales will go to the Company. Because LLC #1 will be a distinct entity from the Company, it should be treated by the Department as a manufacturing company eligible for the MM&E exemption on qualifying purchases. Furthermore, it should be eligible to earn Manufacturer's Purchase Credit when purchasing exempt manufacturing machinery and equipment in accordance with Section 130.331 of the Department's regulations. 86 Ill. Adm. Cd. 130.331.

Second, the Company intends to create a single member limited liability company to which it will transfer all transportation assets. This LLC ('LLC #2') will be a trucking company--an interstate carrier for hire--performing all the transportation functions currently performed within the Company. LLC #2 will provide transportation services for hire to the Company, to LLC #1, and to other, unrelated customers. LLC #2 will routinely carry property for hire in interstate commerce between STATE and Illinois. Most of the services will be provided to either the Company or LLC #1. LLC #2 will be properly organized and registered to transport property as an interstate carrier for hire. Proper documentation of its contracts and rates will be maintained. Services will be provided at fair market rates. LLC #2's services to both the Company and to LLC #1 should be treated by the Department as 'carrying property for hire' in the same way as services provided to unrelated customers. Therefore, LLC #2's services to these related companies should be taken into account by the Department in determining eligibility for the rolling stock exemption on the transportation equipment that it purchases.

There are no documents relevant to this request for the Department to review. No audit or litigation is pending with the Department regarding these issues. The Department has not previously ruled on the same or a similar issue for the Company, nor has the Company ever submitted the same or a similar issue and then withdrawn it before a letter ruling was issued.

The Company has previously requested a ruling regarding its eligibility to purchase MM&E tax-free in its current organizational structure (See ST-02-0154-GIL, 7/15/02). It was informed that, in its current corporate structure, it is not entitled to the exemption on its purchases of MM&E because it uses more than 50% of the products it produces in its own construction business. It, therefore, does not use the MM&E 'primarily in manufacturing or assembling tangible personal property for wholesale or retail sale or

lease.’ The Department cited G.S. Lyons & Sons Lumber & Mfg. Co. v. Department of Revenue, 23 Ill.2d 180 (1961) and T.M. Madden & Co. v. Department of Revenue, 272 Ill. App. 3d 212 (2nd Dist. 1995) to support its position. However, the Department indicated in its General Information Letter, ‘On the other hand, if a business were to sell to retail customers the majority of the asphalt or concrete, then it could qualify for the exemption because the primary use of the equipment or machines would be the production of tangible personal property for sale.’

In Illinois Valley Paving, Inc. v. Department of Revenue, 294 Ill. App. 3d 1123 (1998), the court distinguished between the situation where manufacturing functions and construction contracting functions are performed within a single business entity and where the same functions are performed in two separate business entities. It relied heavily on Van's Material Co. v. Department of Revenue, 131 Ill. 2d 196 (1989), as it concluded ‘that a reasonable difference exists between combined and separate asphalt and construction operations that corresponds with the qualifying conditions for the exemption--namely, that the machinery or equipment must be used primarily to produce property for sale or lease.’ The court went on to note ‘that taxpayers are free, within limits, to structure their business organizations to minimize taxes. Taxpayers may create a subsidiary and then logically and intelligently arrange their affairs in accordance with the letter and spirit of the law.’

The Company believes that the authorities cited above provide ample support for the position that, upon reorganizing, LLC #1 would be eligible for the MM&E exemption on qualifying purchases, and LLC #2 would be eligible for the rolling stock exemption on qualifying purchases. The authorities above call for the Department to acknowledge the existence of the separate and distinct, though related, entities. Thus, even though the majority of business is still transacted among the related companies, LLC #1 must be treated as a true manufacturer making products for wholesale or retail sale, and LLC #2 must be treated as a carrier for hire, providing services under contract to the related companies and others. Therefore, the new entities must be eligible for their respective exemptions on qualifying purchases. We are not aware of any authorities contrary to our position.

The Company requests a ruling by the Department that sales by the manufacturing company, LLC #1, to the Company constitute ‘wholesale or retail sales’ as used in Section 130.330(a) of the Department's regulations, and that, to the extent that LLC #1 purchases MM&E that otherwise qualifies for the MM&E exemption, LLC #1 will be eligible for the exemption, because it uses the MM&E ‘primarily in manufacturing or assembling tangible personal property for wholesale or retail sale or lease.’ In addition, the Company requests a ruling that LLC #1 will be eligible to earn MPC on qualified purchases of exempt M&E.

The Company also requests a ruling that the Department will treat the transportation services to be provided by LLC #2 to either the Company or to LLC #1 as ‘carrying property for hire’ as that term is used in Section 130.340 of the Department's regulations, and that such services will be taken into account when the Department determines whether LLC #2's transportation equipment qualifies as tax-exempt ‘rolling stock moving in interstate commerce.’

Because the reorganization is planned for January 1, 2003, and because substantial purchases will be made at that time, the Company respectfully seeks an expedited

response to this request in order to have assurance of the Department's treatment of the new LLCs.

Thank you very much for your attention to this matter. There is no specific trade secret information that needs to be deleted from the publicly disseminated version of the private letter ruling. Attached is a properly executed power of attorney. If you have any questions, or need any additional information, please contact me.

Under the Retailers' Occupation Tax Act, the manufacturing machinery and equipment exemption is available for machinery and equipment used primarily (over 50% of the time) in the manufacturing or assembling of tangible personal property for wholesale or retail sale or lease. See 86 Ill. Adm. Code 130.330, enclosed. The exemption also extends to repair and replacement parts as long as the parts are incorporated into machinery and equipment that is exempt under the regulation.

When the company is reorganized in the manner described in your letter, LLC#1 will be eligible to utilize the manufacturing machinery and equipment exemption for purchases of qualified equipment and would be able to earn manufacturer's purchase credit on qualifying purchases.

As you know, the Illinois Retailers' Occupation Tax and Use Tax do not apply to sales of tangible personal property to interstate carriers for hire for use as rolling stock moving in interstate commerce. The Department's rules governing the rolling stock exemption are found at 86 Ill. Adm. Code 130.340, copy enclosed.

The exemption applies to sales of tangible personal property to lessors under leases of one year or longer executed or in effect at the time of purchase with interstate carriers for hire for use as rolling stock moving in interstate commerce. A lessor will not incur Use Tax on the purchase of the vehicle that is leased to the interstate carrier for hire for use as rolling stock moving in interstate commerce under a lease term of one year or longer. See 35 ILCS 105/3-55(b) and 120/2-5(12). If a lessor leases a vehicle to an interstate carrier for hire under a lease term of less than one year, the rolling stock exemption is also available because the tax does not apply to the use by (or sale to) lessors, owners, or shippers of tangible personal property that is utilized by interstate carriers for hire for use as rolling stock moving in interstate commerce. See 35 ILCS 105/3-55(c) and 120/2-5(13).

Effective August 14, 1999, motor vehicles, trailers, and property attached to those motor vehicles and trailers must carry persons or property for hire in interstate commerce on 15 or more occasions within a 12- month period to qualify for the exemption. See 35 ILCS 120/2-51. For other types of property used in interstate commerce, the interstate carriers must be able to show, from their books and records, that the property has moved in interstate commerce for hire on a regular and frequent basis in order to qualify for the exemption.

Purchasers also must be recognized by the appropriate federal or state regulatory agency as interstate carriers for hire and have received a Certificate of Authority to engage in interstate commerce. Please note that it is not the type of item that determines whether or not it qualifies as rolling stock, but rather how a qualifying interstate carrier uses the item. In addition to receiving the proper Certificate of Authority, purchasers should be aware that only those items used specifically as rolling stock would qualify. See the enclosed copy of 86 Ill. Adm. Code 130.340.

When making a purchase of qualifying property, the purchasers must provide the sellers with a certification that they are interstate carriers for hire and that they are purchasing the property for use as rolling stock moving in interstate commerce. If the purchasers are lessors, the purchasers must

give the sellers a certification to that effect identifying the lessee interstate carriers for hire. Form RUT-7, Rolling Stock Affidavit, which is signed by the purchasers, is used to provide the required certification in order to execute the statutory exemption.

According to the facts in your letter, when the company reorganizes, LLC#2 will be created to be an interstate carrier for hire in compliance with 86 Ill. Adm. Code 130.340. In that instance, the purchases of qualifying tangible personal property by LLC#2 will qualify for the rolling stock exemption.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules, or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.